

TEACHERS' RETIREMENT BOARD  
BUDGETS AND AUDITS COMMITTEE

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SUBJECT: Internal Audits Final Report

ITEM NUMBER: 11

ATTACHMENTS: 1

ACTION: \_\_\_\_\_

DATE OF MEETING: July 13, 2000

INFORMATION: X

PRESENTER: Way Lee

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In accordance with Internal Auditing Standards, we have taken steps to follow-up on prior internal audits performed by the Office of Audits. Follow-up procedures are required to ascertain that appropriate action was taken regarding audit findings (or observations) identified within final audit reports. Internal Auditing Standards recognize that management is responsible for deciding the appropriate action to be taken in response to reported audit findings and that management may decide to assume the risk of not correcting the reported condition because of cost or other considerations.

At attachment 1 we have provided a current status report on all internal audits completed since January 1997. We intend to provide the Budgets & Audits Committee with a similar quarterly status report on an ongoing basis.

**RESOLUTION OF INTERNAL AUDIT FINDINGS/OBSERVATIONS, Status as of 6/20/00**

<b>Auditee</b>	<b>Audit # / Audit Activity</b>	<b>Period Reviewed</b>	<b>Report Issue Date</b>	<b>Description of Finding/Observation</b>	<b>Resolution or Status of Finding/Observation</b>	<b>F/U Status</b>
Support Accounting & Business Services, Administration Branch,	#A-95012 SAM 20000 Audit	FY 94/95 to 95/96	7/97	1. Properties with acquisition costs of \$5,000 or more are not capitalized in the accounting records.	Concur & corrected. Management developed a project plan to develop and implement procedures for capitalizing and depreciating assets in accordance with GASB 25.	A C N
				2. The Fiscal Services Div. inappropriately used the office revolving fund to pay for costs or expenses incurred while training school district payroll staff during the Employer Institute program.	Concur & corrected. Effective 7/1/97, all Employer Institute related expenditures will be budgeted/recorded in the Admin. Mgmt. Unit. A new expense code, 217.02, was established for such expenditures. A budget allotment of \$10,000 and a scheduled reimbursement of \$25,000 was established.	A C N
Survivor Benefits (S/B), Client Benefits and Services Branch	#A-95016 Detecting the Unreported Deaths of Benefit Recipients	7/95 to 10/98	7/99	1. S/B staff did not process the SCO's semi-annual death match reports for the period 10/95 to 4/97.	Concur & corrected. Management has updated operating procedures to provide staff with direction in evaluating, analyzing, and processing the reports. The related workload is being tracked and monitored within the monthly executive report.	A C N
				2. S/B did not establish formal timeframes for processing death match listings and did not enforce documentation deadlines, which resulted in untimely resolution of certain death cases.	Concur & corrected. Management has established formal timeframes for working the reports, monitoring cases that exceed timeframes, and stopping benefit payments in a timely manner.	A C N

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				3. For annuitants reported as "deceased in error" by another governmental agency, S/B staff did not always enforce procedures that require annuitants to submit verification of their identity and entitlement.	Concur & corrected. Management will closely monitor and evaluate cases in which payees claim hardship in complying with identity requirements. Overrides of verification requirements will be approved by the Disability and Survivor Benefits Div. Chief and reported monthly to the DCEO.	A C N
Corp. Gov. & External Equities, Investments Branch	#A-96018 / 96020 Audit of External Managers' Evaluation Process	10/96 to 7/98	5/99	1. Management should develop written procedures for liquidating the portfolios of terminated external managers.	Concur & in progress. Development of procedures for portfolio liquidation are being considered. Risk related to this issue is mitigated due to the pool of managers in place.	A C
Fixed Income, Investments Branch	#A-96019 / 96021 Review of Fixed Income Securities	7/96 to 10/11/96	2/97	1. Some broker/dealers did not meet minimum requirements for broker/dealer selection set forth within CalSTRS' Investment Policy and some broker files did not contain sufficient documentation to verify that requirements were met.  2. The trade ticket number and the requester's name are not always entered on the Check-Out Log for	Concur & corrected. A desk manual was created to ensure that the broker file documentation problems are eliminated.  Concur & corrected. Existing procedures were modified to ensure that the Check-Out Log is thoroughly completed with each	A C V N  A C N

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				SELL and BUY tickets.	transaction.	
Investment Operations, Investments Branch	#A-96023 Cash Receipts & Cash Disbursements	6/97 to 8/97	4/98	<ol style="list-style-type: none"> <li>Checks received by Inv. Ops. are not endorsed prior to being sent to the master custodian for credit to CalSTRS' account.</li> <li>Claim schedule <u>file copies</u> do not bear evidence of authorization or approval.</li> <li>Requests to deny access to certain computer applications are not always executed timely.</li> </ol>	<p>Concur &amp; corrected. State Street Bank, the master custodian, prepared an endorsement stamp for Inv. Ops. staff to use restrictively for endorsing checks.</p> <p>Concur &amp; corrected. Claim schedule file copies are now initialed by the person approving the claim forwarded to the SCO.</p> <p>Concur &amp; corrected. The Inv. Br. began using a new Computer Access Clearance form in 4/98 and implemented procedures for tracking staff's computer access.</p>	<p>A C N</p> <p>A C N</p> <p>A C N</p>
Disability Services (D/S), Client Benefits & Services Branch	#A-96024 Disability Benefit Application Process Audit	CY 1996	6/98	<ol style="list-style-type: none"> <li>Standard Operating Procedures for the Disability Services Program have not been updated.</li> <li>Sufficient documentation is not being obtained to verify the financial dependency of a member's child at the time of application. Auditor recommended that current law be reviewed for proper compliance</li> </ol>	<p>Concur &amp; in progress. See response to Audit #A-97026, Finding 1.</p> <p>Disagree. Staff use the child's age and the member's certified signature on the application to verify financial dependency. However, management does recognize that there are situations for which further documentation is needed.</p>	<p>A C</p> <p>D N</p>

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				and that necessary procedures be implemented.  3. CalSTRS uses the postmark date, rather than the CalSTRS receipt date to record the date an application is received.	Concur & corrected. A policy to use only the application "receipt date" has been instituted.	A C N
Admin. Serv. Div., Admin. Br., & Accounting Div., Information & Financial Systems Br.	#A-96025 Financial & Management Reporting Process	7/96 to 1/97	1/13/98	1. Claim Schedules prepared in Support Acctng. did not reflect the signature of the person authorized to provide approval.	Concur & corrected. Staff have been separating the file copy of the claim schedules (C/S) prior to obtaining a signed approval of the claim. Consequently, there was no evidence of approval on the C/S file copies housed in Support Acctng. Staff have been instructed to sign the complete claim schedule upon their review/approval prior to separating the C/S copies.	A C N
Disability Services (D/S), Client Benefits & Services Br.	#A-97026 Payments & Adjustments of Disability Benefits (aka Disability Benefits Audit)	1/96 to 9/97	8/98	1. The D/S section has not developed or updated written policies and procedures to identify its current critical processes and related activities.	Concur & in progress. Policies and procedures have been completed in draft form and will be finalized once the DITO and START systems are fully deployed. D/S intends to eventually deploy all policies and procedures electronically via an Intranet or LAN server.	A C

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				<p>2. When adjusting some members' final compensation benefits, staff must override existing information in order to calculate the adjusted compensation amount. Over-ridden data will not be picked up by the system once START is implemented.</p> <p>3. Staff did not always date and initial the calculation forms used to document their manual calculation of members' final compensation amounts.</p>	<p>Concur &amp; corrected. According to the START system experts, over-ridden data will continue to exist in the START environment. Similar to IDMS , there will continue to be occasions when staff will need to override the calculator. For example, overrides are needed for calculations of part-time and/or non-consecutive years and for Option 8 benefit calculations.</p> <p>Concur &amp; corrected. All calculation technicians are currently signing and dating the manual calculation forms. Staff is working to deploy all D/S forms on the Intranet. The version control functionality of the software allows for author, version, and date control for each document. This will provide an unalterable historical audit trail for the forms.</p>	<p>A C N</p> <p>A C N</p>
Alternative Investments, Investments Branch	#A-97027 Alternative Investments	CY 1997	12/98	1. The Alternative Investments Policy was not revised to reflect the current environment of the Alt. Inv. unit and did not provide guidelines for the portfolio structure.	Concur & corrected. The Alternative Investments Policy & Procedures Manual was revised and approved by the Inv. Comm. at the 6/3/98 meeting.	A C V N

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				2. The partnership legal file is not always consulted to determine the actual fund size of the investment prior to preparing the Alternative Investment Status Report.	Concur & corrected. All partnership agreements have been reviewed to validate the fund size. Written documentation was obtained to support general partner's commitments. Staff are reviewing each fund to obtain a final closing set of documents. The monthly status report, effective 5/98, identifies commitments in international funds and footnotes currency conversion information.	A C V N
				3. Some funds' management fees are inappropriately being capitalized and are not being recognized as an expense.	Concur & corrected. Staff have identified all inappropriately capitalized fees, have adjusted the commitment amount for each partnership, and have obtained Inv. Comm. approval of the increased commitments.	A C V N
				4. Staff are processing capital call requests and wiring funds to partnerships prior to verifying the authenticity of the request. Funds are released based on facsimiles and photocopies of capital call notices. Notices are not always signed by authorized personnel. Also, verbal confirmations, from the general partner, are not always obtained and/or documented on the request.	Concur & corrected. New partnership agreements include the name and specimen signature of authorized personnel. Staff have been instructed to obtain verbal confirmation of all capital call requests and document the confirmation, prior to wiring funds.	A C N

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				<p>5. There are several weaknesses within the internal control system over CalSTRS' Alt. Inv. Function.</p> <p>(a)The Alt. Inv. unit does not have adequate separation of duties over its stock process, including stock monitoring, sales, and distribution activities.</p> <p>(b)The Inv. Br. does not maintain an independent record of (Alt. Inv. portfolio) stock held by the master custodian or by brokers.</p> <p>(c)The gain or loss from stock sales is not included within the Alt. Inv. Monthly Report to the Inv. Comm.</p>	<p>(a) Concur &amp; corrected. The Internal Equity unit, within the Inv. Br., now manages the sale of stock and performs a secondary level of review for all sale recommendations. The stock distribution and accounting process is performed within the Alt. Inv. Unit and activities are reported to Int. Eq.</p> <p>(b) Disagree. Int. Eq. staff currently monitor custodial records of stock (held by custodian) and reconcile differences with the custodian. All stock is now transferred to the custodian with none being held by the broker.</p> <p>(c) Concur &amp; in progress. Data regarding the gain/loss on stock sales is currently included within the consultant's Alt. Inv. Monthly Report. Staff are in the process of further enhancing CalSTRS' (internal) monthly report to calculate stock performance for this specific part of the portfolio. Ultimately, staff intend to report this data to the Inv. Comm.</p>	<p>A,C,N</p> <p>D,N</p> <p>A,C</p>

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Fixed Income, Investments Branch	#A-98029 Securities Lending Program	CY 1998	2/00	<p><b>Note:</b> Observations identified within the audit report were grouped into the following four categories:</p> <p>1. <b>Monitoring:</b> Staff could improve monitoring activities and provide more oversight of S/L agents' compliance with contract and program policy requirements. Specifically, staff should more closely monitor:  (a) agents' daily collateral margin maintenance,  (b) agents' submission of financial reports, and  (c) evidence regarding agents' reevaluations of borrowers' creditworthiness.  (d) Staff should more thoroughly monitor agents' S/L program result reports and  (e) document their review and use of external reports provided by the S/L consultant.</p>	<p>Management intends to assign additional staff to the program to perform some of the following additional duties.</p> <p>(a) Concur &amp; corrected. Agents' daily collateral value reports are being closely tracked and monitored.</p> <p>(b) Concur &amp; in progress. Staff are implementing a new monitoring system to track, review, and evaluate agents' financial and other reports.</p> <p>(c) Concur &amp; in progress. Staff are standardizing the format for agents to report borrower listings.</p> <p>(d) Concur &amp; corrected. Agents have been directed to perform monthly reconciliations with the custodian and to submit audit reports covering their internal controls.</p> <p>(e) Concur &amp; corrected. The consultant's reports are being more fully monitored and documented for follow-up.</p>	<p>A,C,N</p> <p>A,C</p> <p>A,C</p> <p>A,C,N</p> <p>A,C,N</p>

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				<p>2. <b>Reporting:</b>  (a) S/L program results were not always reported accurately within monthly reports to the CIO &amp; Inv. Comm. due to the variety of reporting formats used by each of the S/L agents.  (b) Also, the format used to report monthly results to the Inv. Comm. is inconsistent in that monthly program earnings are excluded.</p> <p>3. <b>Procedures:</b>  Staff should develop new or enhance existing procedures/guidelines for some key processes. This includes:  (a) enhancing guidelines for (internal) management of cash collateral portfolios,  (b) developing custodial instructions for holding back a portion of all loanable assets, and  (c) maintaining existing procedures regarding the recall and voting of loaned securities.</p>	<p>(a) Concur &amp; in progress. Staff will develop standardized reporting formats for the agents with the new contracts that will result from the RFP process. Previous reporting errors have been resolved and corrected.</p> <p>(b) Disagree. The format used by the CIO to report monthly program results to the Inv. Comm. Was one requested by the Inv. Comm. Itself.</p>	<p>A,C</p> <p>D,N</p>
					<p>(a) Concur &amp; in progress. The F/I unit will maintain a written Desk Manual to document workflow and processes that relate to the written procedures for the S/L Program.</p> <p>(b) Concur &amp; in progress. Staff will ensure that a portion of loanable securities are held back.</p> <p>(c) Concur &amp; in progress. Procedures regarding the recall and voting of loaned securities will be included within either the S/L or Corporate Governance manuals.</p>	<p>A, C</p> <p>A,C</p> <p>A,C</p>

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				<p>4. <b>Agent Contracts:</b></p> <p>(a) S/L agents' contract language is not standardized with regard to earnings requirements and reporting format requirements.</p> <p>(b) Indemnification clauses could be strengthened.</p> <p>(c) Agents could be provided with more specific guidelines regarding their mark-to-market activities,</p> <p>(d) borrower selection criteria, and</p> <p>(e) management of cash collateral investments.</p>	<p>(a) Concur &amp; in progress. Agent contract standardization will be realized through the RFP process and upcoming Program restructuring.</p> <p>(b) Concur &amp; in progress. Upon negotiating new contracts, staff will continue to seek all opportunities to mitigate risks associated with S/L.</p> <p>(c) Concur &amp; corrected. Agents are using a new process for transmitting daily collateral level data.</p> <p>(d) Concur &amp; in progress. Staff is developing a standardized format for agents to submit their borrower listings.</p> <p>(e) Disagree. Staff closely monitor agents' investment activities but management is reluctant to dictate specific investment guidelines to agents since it could hinder agents' abilities to implement their (own) investment strategies.</p>	<p>A,C</p> <p>A,C</p> <p>A,C,N</p> <p>A,C</p> <p>D,N</p>
Service Retirements Div., Client Benefits & Services Br.	#A-99032 Inactive Member Accounts	7/94 to 3/99	3/00	<p>1. CalSTRS has not made a good faith effort to periodically locate its inactive members and inform them concerning their pension benefits as required by California Education Code, Section</p>	<p>Concur &amp; in progress. Staff will review and consider its approach to contacting members, the responsibility to update the addresses of inactive members and the frequency of performing "death match" searches. This effort should be reported to</p>	<p>A C</p>

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				22309(b).	the Benefits and Services Comm. for approval. Policies & procedures will be updated to reflect the direction provided by this report.	
				2. One staff member who had access to inactive member account data was assigned incompatible computer functions within CalSTRS' information system.	Concur & corrected. The staff member's access to various computer functions has been realigned.	A C N
				3. The Service Retirements Div. does not have adequate internal controls to ensure that inactive member refunds are made only to those members entitled to the refund.	Concur & in progress. Staff will review, analyze, and update current procedures based on industry best practices, legal considerations, and levels of risk and liability.	A C

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